

INVITATION FOR COMMENTS
PROPOSED CALIFORNIA INVESTMENT ADVISER REGULATIONS
(Additions shown by underline and deletions shown by strikethrough.)

1. Amend Section 260.204.9

§ 260.204.9. ~~Exemption for Certain Investment Advisers with fewer than 15 Clients.~~Exemption for Certain Investment Advisers to Private Funds.

(a) An exemption from the provisions of Section 25230 of the Code is hereby granted, as being necessary and appropriate in the public interest ~~and for the protection of investors,~~ to any person who ~~(1) does not hold itself out generally to the public as an investment adviser, (2) has fewer than 15 clients, (3) is exempt from registration under the federal Investment Advisers Act of 1940, as amended, by virtue of Section 203(b)(3) of that act, and (4) either (i) has assets under management, as defined in subsection (b)(2), of not less than \$25,000,000 or (ii) provides investment advice to only venture capital companies, as defined in subsection (b)(3).~~satisfies the following conditions:

(1) Disqualification: Neither the person nor any of its affiliated persons (1) are subject to a disqualification as described in Rule 262 of the Securities and Exchange Commission (17 CFR Sec. 230.262), or (2) have done any of the acts, satisfy any of the circumstances, or are subject to any order specified in section 25232, subdivisions (a) through (h) of the Corporate Securities Law of 1968, or any successor thereto.

(2) The person acts an adviser solely to private funds, as defined in subsection (b)(1) of this rule.

(3) Application: The person files with the Commissioner an application consisting of a copy of each report and amendment thereto that an exempt reporting adviser under the Investment Adviser Act of 1940 would be required to file with the Securities and Exchange Commission pursuant to Securities and Exchange

Commission Rule 204-4 (17 CFR Sec. 275.204-4),¹ a Customer Authorization of Disclosure of Financial Records, set forth in section 260.231(i), and a Consent to Service of Process set forth in section 260.165.

(4) Application fee: The fee for filing an application is \$125 as prescribed in Section 25608(q). The payment of this fee shall keep the exemption in effect during the calendar year during which it is granted. The applicant shall remit the fee directly with IARD in accordance with its procedures for transmission to the Commissioner. Fees are not refundable except pursuant to Government Code Sections 13140 through 13144.

(5) The person either (i) has assets under management as defined in subsection (b)(2), of not less than \$100,000,000 or (ii) provides investment advice only to venture capital companies, as defined in subsection (b)(3).

(6) The person is exempted from registration with the Securities and Exchange Commission under Section 203(l) or (m) of Investment Adviser Act of 1940 (15 U.S.C. 80b-3(l) or 80b-3(m)).

(b) For purposes of this rule, the following definitions shall apply:

~~(1) Client shall have the same meaning as defined by the Securities and Exchange Commission under the rule adopted pursuant to Section 222(d) of the federal Investment Advisers Act of 1940, as amended.~~ "Private fund" means an issuer that would be an investment company, as defined in Section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), but for Section 3(c)(1) or 3(c)(7) of that Act.

(2) "Assets under management" means the securities with respect to which an investment adviser and its affiliated persons provide continuous and regular supervisory or management services; provided, that in the case of securities managed for an entity

¹ The application referred to in this subsection will be revised as necessary upon final adoption of Rule 204-4 by the Securities and Exchange Commission.

which is excluded from the definition of investment company by the exclusion provided in Section 3(c)(1) or Section 3(c)(7) of the federal Investment Company Act of 1940, as amended, assets under management shall also include any amount payable to such entity pursuant to a firm agreement or similar binding commitment pursuant to which a person has agreed to acquire an interest in, or make capital contributions to, the entity upon demand of such entity.

(3) An entity is a “venture capital company” if, on at least one occasion during the annual period commencing with the date of its initial capitalization, and on at least one occasion during each annual period thereafter, at least fifty percent (50%) of its assets (other than short-term investments pending long-term commitment of distribution to investors), valued at cost, are venture capital investments, defined in subsection (b)(4) or derivative investments described in subsection (b)(5).

(4) A “venture capital investment” is an acquisition of securities in an operating company as to which the investment adviser, the entity advised by the investment adviser, or an affiliated person of either has or obtains management rights as defined in subsection (b)(6).

(5) An acquisition of securities is a “derivative investment” if it is acquired by a venture capital company in the ordinary course of its business in exchange for an existing venture capital investment either (i) upon the exercise or conversion of the existing venture capital investment or (ii) in connection with a public offering of securities or the merger or reorganization of the operating company to which the existing venture capital investment relates.

(6) “Management rights” means the right, obtained contractually or through ownership of securities, either through one person alone or in conjunction with one or more persons acting together or through an affiliated person, to substantially participate

in, to substantially influence the conduct of, or to provide (or to offer to provide) significant guidance and counsel concerning, the management, operations or business objectives of the operating company in which the venture capital investment is made.

(7) An “operating company” means an entity that is primarily engaged, directly or through a majority owned subsidiary or subsidiaries, in the production or sale (including any research or development) of a product or service other than the management or investment of capital, but shall not include an individual or sole proprietorship.

(8) “Affiliated person” means a person that controls, is controlled by, or is under common control with the other specified persons. Control means possessing directly or indirectly, the power to direct or cause the direction of management and policies.

(c) The application described in subsection (a)(3) of this rule, shall be made electronically through the IARD, with the exception that the Customer Authorization of Disclosure of Financial Records and the Consent to Service of Process shall be submitted directly to the Commissioner. An application shall be deemed approved when (i) the report and the application fee are filed and accepted by the IARD on the Commissioner's behalf, and (ii) the Customer Authorization of Disclosure of Financial Records and the Consent to Service of Process have been filed with the Commissioner.

Note: Authority cited: Section 25204 and 25610, Corporations Code. Reference: Section 25230, Corporations Code.